Including thrifts in bank merger analysis

John J. Di Clemente

Under the Bank Merger Act of 1966 and the Bank Holding Company Act of 1956, federal banking authorities are required to assess the competitive effects of bank mergers and acquisitions. In the traditional analysis the process usually begins with a determination of the geographic market(s) in which the combining institutions compete. The relevant product market, or "line of commerce" in antitrust parlance, is generally taken to be commercial banking inasmuch as the United States Supreme Court has repeatedly held that, for the purposes of antitrust analysis, commercial banks compete only with other commercial banks.

This paper assesses the impact on bank merger analysis of including thrift institutions (savings and loan associations and savings banks) as if they were full competitors of commercial banks. Asset and liability powers of thrifts have changed considerably since the Supreme Court last affirmed its line of commerce determination in 1974. The lines separating commercial banks from thrift institutions have become increasingly obscure. This process of homogenization may be expected to continue in view of recent legislative initiatives.

This paper is organized into five sections. The first reviews the Supreme Court’s rationale in determining that commercial banking is a relevant line of commerce in bank merger analysis. The second discusses the changes in the financial system that have occurred which might tend to vitiate the Court’s position since its last pronouncement on the subject. The position of the Board of Governors of the Federal Reserve System (the Board) is then examined. An assessment of the impact of expanding the product line in bank merger analysis to include thrift institutions follows. Hypothetical mergers in Seventh District markets are judged against an appropriate merger standard to assess whether such mergers would pass muster under the antitrust law. A final section provides some overall remarks.

The Supreme Court and the relevant line of commerce

Philadelphia National Bank. In 1963 the Supreme Court decided for the first time that, for the purposes of bank merger analysis under the antitrust laws of the United States, the relevant line of commerce is commercial banking. In U.S. v. Philadelphia National Bank 374 U.S. 321 (1963), the Court said

"We have no difficulty in determining the "line of commerce" (relevant product or services market) and "section of the country" (relevant geographic market) in which to appraise the probable competitive effects of appellees’ proposed merger. We agree with the District Court that the cluster of products (various kinds of credit) and services (such as checking accounts and trust administration) denoted by the term 'commercial banking' . . . composes a distinct line of commerce."²

To support its conclusion, the Court relied on three arguments. First, it concluded that "some commercial banking products or services are so distinctive that they are entirely free of effective competition from products or services of other financial institutions; the checking account is in this category."³ Secondly, the court

---

¹A similar analysis was undertaken by Alcaly and Nelson with regard to local banking markets in New York and New Jersey. (Roger E. Alcaly and Richard W. Nelson, "Will Including Thrifts in the Banking Market Affect Mergers?", Banking Law Journal (April 1980).)


³Philadelphia at 356.
determined that other bank products or services enjoy "such cost advantages as to be insulated within a broad range from substitutes furnished by other institutions ....". Lastly, the Court indicated that, although some bank services and products are freely competitive with services and products available at other financial institutions, commercial banks "nevertheless enjoy a settled consumer preference, insulating them, to a marked degree, from competition; this seems to be the case with savings deposits."

In summary, commercial banks, in the Court's view, provided unique products; products not unique but supported by cost advantages and products which, although neither unique nor supported by cost advantages, consumers preferred to similar products offered by other institutions.

The Court, however, was not blind to the fact that banks did compete to some extent with other financial institutions. This is demonstrated in the Court's general overview of the banking industry preceding its analysis of the merger before it. The Court said:

"It should be noted that many other financial institutions are in the business of supplying credit, and so more or less in competition with commercial banks... for example: mutual savings banks, savings and loan associations, credit unions, ....".

While the Court noted the competition provided by other institutions, the "more or less" hints at its result in determining commercial banking to be a distinct line of commerce. For the Court at that time, the degree to which other institutions were in competition with banks was decidedly rather "less" than "more".

Philadelphia National Bank. The next major case involving the relevant line of commerce in bank merger analysis before the Supreme Court was that of U.S. v. Philadelphia National Bank 399 U.S. 350 (1970). In Philadelphia, the Court severely criticized the lower district court for focusing on submarkets. The district court believed that, because the defendant banks functioned more as savings institutions than they did commercial banks, competition from other than commercial banks must be analyzed. The Supreme Court rejected this reasoning:

"Submarkets such as the District Court defined would be clearly relevant, for example, in analyzing the effect on competition of a merger between a commercial bank and another type of financial institution. But submarkets are not a basis for the disregard of a broader line of commerce that has economic significance."

The Court further described the reasoning which led to its conclusion that commercial banking was a distinct line of commerce in Philadelphia, employing what has come to be known as the "department store of finance" approach:

"Philadelphia Bank emphasized that it is the cluster of products and services that full-service banks offer that as a matter of trade reality makes commercial banking a distinct line of commerce.... In short, the cluster of products and services termed commercial banking has economic significance well beyond the various products and services involved."*

Thus, the Court could argue, for example, that banks and thrifts may resemble each other to a marked degree, yet banks, because they possess certain products not then legally available at thrifts, are separate from thrifts for the purposes of bank merger analysis. In the Court's view, each bank product was somehow intimately related to other bank products and together constituted "commercial banking".


*Philadelphia at 356.
*Philadelphia at 357.
*Philadelphia at 326.

**Philadelphia at 360-61. Emphasis in original.
decisions in *Philadelphia* and *Phillipsburg* do not require that courts ignore economic realities in assessing bank mergers. In *Connecticut* the Court held out the promise that someday thrifts may be included in the same product market as commercial banks.

In *Connecticut* the Court found that the district court had erred in including both savings and commercial banks in the same product market notwithstanding the close resemblance of commercial banks and savings banks in Connecticut. The Court stated:

"To be sure, there is a large measure of similarity between the services marketed by the two categories of banks. In our view, however, the overlap is not sufficient at this stage in the development of savings banks in Connecticut to treat them together with commercial banks in the instant case. Despite the strides that savings banks in that State have made towards parity with commercial banks, the latter continue to be able to provide a cluster of services that the former cannot, particularly with regard to commercial customers, and this Court has repeatedly held that it is the unique cluster of services provided by commercial banks that sets them apart for purposes of section 7."  

The fact that there existed differences in what commercial banks and what savings banks could offer customers was the justification for treating commercial banking as a distinct line of commerce. The Court recognized that for non-business customers a savings bank and a commercial bank may serve as reasonable substitutes. It was held that the distinguishing features of commercial banks lay in their ability to serve commercial enterprises.

More specifically, the Court stated:

"We do not say, and Phillipsburg National Bank and . . . Philadelphia National Bank . . . do not say, that in a case involving a merger of commercial banks a court may never consider savings banks and commercial banks as operating in the same line of commerce, no matter how similar their services and economic behavior. At some stage in the development of savings banks it will be unrealistic to distinguish them from commercial banks for purposes of the Clayton Act. In Connecticut, that point may well be reached when and if savings banks become significant participants in the marketing of bank services to commercial enterprises."  

In *Connecticut*, the door was left open for the inclusion of thrifts in commercial bank merger analysis.

### The changing financial landscape

The Supreme Court in *Connecticut* did not require that thrift services completely overlap those of commercial banks before such institutions could be considered competitors of the latter. The Court, however, did distinguish savings banks from commercial banks in Connecticut by indicating some of the services that commercial banks could offer but that savings banks could not. More specifically,

"Commercial banks in the State offer credit-card plans, loans for securities purchases, trust services, computer and account services, and letters of credit. Savings banks do not."  

In addition to these services, one may add the offering of personal and commercial checking accounts and unsecured commercial loans as distinguishing savings banks from commercial banks in Connecticut, although state law was soon to grant savings banks the authority to offer personal checking accounts.

In the face of significant changes occurring in the financial system since 1974, many commentators believe that the time has come for a reappraisal of the Supreme Court's "line of

---

9 *U.S. v. Connecticut National Bank* 418 U.S. 656, 663-64. Emphasis added
10 *Connecticut* at 663.
11 *Connecticut* at 666.
12 *Connecticut* at 665.
commerce. Since the decision in Connecticut, there has been an intensification of competition among financial institutions. Services once thought to be unique to commercial banks are no longer unique. The forces compelling this result reflect for the most part pressures of the market economy.

Individuals and businesses have become much more sophisticated regarding their financial transactions. Gone is the day when corporations would maintain large sums of idle cash. Today, both individuals and businesses use cash management techniques to reduce cash balances to a minimum so as to achieve higher returns on invested funds. As individuals and businesses become more opportunity-cost conscious as a result of inflation, banks and other financial institutions must respond or be left behind. Money market mutual funds are just one manifestation of the innovative financial system. As George Kaufman has noted:

"All products have their life spans and the traditional bundle of products offered by commercial banks since the beginning of the twentieth century, whether or not unique or separate, was reaching the end of its life. But its death was hastened in recent years by a new and unpredictable event—virile inflation. Combined with the predictable advancement in technology, outmoded regulation, and the creativeness and resourcefulness of participants in the financial markets, the high and volatile interest rates generated by the inflation have left the old order in shambles, e.g., the virtual bankruptcy of [savings and loan associations] and the almost full grown birth of money market funds. The changes occurred with such speed that market deregulation did not wait for legal deregulation." 

**Legislative change**

Pressures building in the financial system have compelled legislative change, loosening the asset and liability restrictions on thrifts to enable them to remain viable. The two most significant legislative changes affecting the competitiveness of thrifts since Connecticut have been the enactment of Public Law 96-221, the Depository Institutions Deregulation and Monetary Control Act of 1980 (Monetary Control Act), and Public Law 97-320, the Garn-St Germain Depository Institutions Act of 1982 (Garn-St Germain). Both acts significantly broaden the asset and liability powers of federally chartered thrifts. However, for purposes of the "line of commerce," Garn-St Germain possesses potential far beyond that of the Monetary Control Act.

The Monetary Control Act authorizes federally chartered savings and loan associations to offer negotiable order of withdrawal (NOW) accounts; establish remote service units; invest up to 20 percent of assets in commercial real estate loans, consumer loans, commercial paper, and corporate debt securities; issue credit cards and extend credit in connection with credit cards; and apply for trust powers. In addition, mutual savings banks were granted the authority to invest up to 5 percent of their assets in commercial loans and to maintain demand deposit accounts in connection with such loans.

---


Thus, federally chartered thrifts became able to offer one-stop shopping convenience to individuals and to be their “department store of finance.” Under the Monetary Control Act, however, thrifts’ ability to serve the commercial customer, that class of customer which was so important to the Supreme Court’s argument in Connecticut, remained more or less restricted. Nevertheless, the overlap between commercial bank services and thrift services was becoming more complete.

With Garn-St Germain the resemblance of federally chartered thrifts to commercial banks becomes even greater. Under Garn-St Germain the ability of thrifts to provide services to commercial enterprises was enhanced in the interest of preserving thrifts as viable institutions. The act increases the percentage of assets that may be invested in nonresidential real estate and consumer loans to 40 percent and 30 percent, respectively. In addition, thrifts can now invest up to 10 percent of capital and surplus in state and local securities and invest up to 10 percent of assets in personal property. Most importantly, thrifts can now invest up to 10 percent of assets in secured or unsecured commercial loans after January 1, 1984, and are able to accept demand deposits in connection with such loans. In all, up to 60 percent of assets may be invested in the various forms of commercial loans.

Now more than before, federally chartered thrifts begin to take on the hue of commercial banks. Whether the expanded powers granted under Garn-St Germain would be sufficient to include thrifts in the relevant line of commerce is problematic. As one observer has noted, the mere authority to offer expanded services does not compel the inclusion of thrifts in the same line of commerce with commercial banks under the Connecticut rationale. To warrant inclusion, thrifts must not only possess the authority to offer services, but must do so to a meaningful degree. It is suggested by the same commentator, however, that this requirement under the Connecticut rationale may be abandoned by the Supreme Court if thrifts were to attain the power to offer a cluster of services that is the substantial equivalent of that which may be offered by commercial banks.16

The Board’s consideration of thrifts

At about the time the Supreme Court was deliberating on Connecticut, the Board had before it an application by an Indiana bank holding company to acquire an Arizona savings and loan association under section 4(c)(8) of the Bank Holding Company Act. As the board had not previously determined that savings and loan association activities were permissible for bank holding companies, it inquired into whether such activities were “closely related” to banking. Just as the Supreme Court was cognizant of the trend toward lessening distinctions between thrifts and commercial banks, so too was the Board:

"Geographic restrictions on mortgage lending by savings and loan associations have been liberalized. Recently, savings and loan associations were permitted by the Federal Home Loan Bank Board to participate in the federal funds market, previously dominated by commercial banks. Savings and loan associations recently were authorized to offer large negotiable certificates of deposits. The role of savings and loan associations in the nation’s payments mechanism is growing. The President’s Commission on Financial Institutions and others have made proposals to expand the powers of savings and loan associations. The close relationship between banking and operation of savings and loan associations would become even closer should these proposals be implemented. Should this trend continue to the point where savings and loan associations both accept demand deposits and engage in the business of making commercial loans, savings and loan associations would actu-

ally become "banks" for purposes of the
[Bank Holding Company] Act."17

While the Board recognized this trend it
was not yet willing to include thrifts in the same
competitive analysis with banks in bank merger
and bank acquisition proposals.

The Board has generally assumed a cautious
approach toward including thrifts in the line of
commerce for bank mergers. This approach can
be traced, in part, to its adherence to the
Supreme Court's dictates in the matter. Howev-
er, the consideration of thrifts has occurred on
a case-by-case basis.

One of the major cases since Connecticut
and enactment of the Monetary Control Act is
Fidelity Union Bancorporation.18 The Board
stated that while it "continues to view com-
mercial banking as most relevant in determining
the competitive effects of a proposal, it may be
appropriate in particular cases to take into con-
sideration direct competition from thrifts in
specific areas in evaluating the various competi-
tive influences." However, the Board felt it
would be "premature" to view thrifts as full
competitors of commercial banks.

The Board’s deliberation in Fidelity Union
Bancorporation led to a more formal considera-
tion of nonbank competition as evidenced by
Bank Holding Company Letter 198 (June 25,
1980), an internal letter outlining the proce-
dures Reserve Banks were to follow if thrifts
were to be included in the competitive analysis.
The letter stipulates that competition among
commercial banks is "most relevant" but provi-
sion is made for the explicit consideration of
thrifts and other nonbank competitors.

The Board, following the Supreme Court's
advice in Connecticut, looks not only at the mere
presence of thrifts in analyzing proposals but
also whether such institutions actively engage in
direct competition with banks:

"In evaluating the competitive effects of
this proposal, the Board has considered
the impact of thrift institutions on com-
petition within the Waco market. Al-
though thrift institutions hold substan-
tial deposits in the Waco banking mar-
ket, the Board in this instance is unable
to conclude from the evidence in the
record that these institutions compete
actively with commercial banks over a
sufficient range of financial services to
mitigate significantly the anticompetitive
effects of the proposal."19

This Board posture is delineated clearly in
the consideration of a proposal by Hartford
National Corporation to acquire Mattatuck Bank
and Trust Company:

"The Board has also evaluated the impact
of thrift institutions within the Water-
bury market. Although a number of
thrifts are located in the market, the
Board is of the opinion that thrift insti-
tutions do not compete actively with
commercial banks over a sufficient range
of financial services to consider them
full competitors of commercial banks.
Thus, even though thrift institutions
hold a substantial amount of the market’s
savings deposits, and make a large number
of the market’s consumer loans, these
institutions are insignificant competi-
tors in the provision of demand deposit
services and commercial loans. In addi-
tion, commercial banks hold the great
majority of the market’s NOW accounts.
This in particular demonstrates the lim-
ited nature of the services provided by
thrifts in the Waterbury market."20

While the Board has declined to include
thrifts as full competitors of commercial banks, it
has cited their presence in a number of cases as
mitigating factors to offset otherwise adverse
competitive effects resulting from commercial
bank mergers. This approach is often referred to
as "shading" in that the market shares and
market concentration levels of commercial banks
are adjusted downward by some fraction of total

17American Fletcher Corporation, 60 Federal Reserve
Bulletin 869 (December 1974).

18Fidelity Union Bancorporation, 66 Federal Reserve
Bulletin 576 (July 1980).

19Republic of Texas Corporation, 66 Federal Reserve

20Hartford National Corporation, 68 Federal Reserve